Public Service Commission of Wisconsin
Rebuttal Testimony of Anne Waymouth
Division of Water, Compliance, and Consumer Affairs

Milwaukee Water Works
Docket 3720-WR-108

June 13, 2014

Q. Are you the same Anne Waymouth that provided direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your testimony?

A. I will make a few initial comments on the testimony of Eric Rothstein, witness for the wholesale interveners. Then, I have a few clarifications in response to the initial testimony of Carrie Lewis, Milwaukee Water Works (MWW) Superintendent. I also will provide further information about how a water utility can evaluate its long-term capital needs. I will suggest the idea that MWW could hire an independent consultant to use MWW's main break records and provide an estimate of MWW's upcoming capital needs for main replacements.

Q. Do you have any initial comments?

A. Yes, first of all I do want to commend MWW in all its efforts to control costs. Pages 3 to 5 of Ms. Lewis' testimony describes the consolidations of functions and uses of new systems which have reduced MWW's costs. Ultimately, it is the ratepayers that benefit from an efficiently operated utility. Overall MWW has reduced many costs since its last rate case and that is commendable. However, the rate case process can also help MWW evaluate its strengths and weaknesses and it is my intent to use such analysis to encourage further improvements.

Q. What are your initial comments on Eric Rothstein's testimony?

A. I believe I addressed the potential concern that MWW has little debt in my initial testimony. By applying the benchmark return to rate base, the return on equity declines as the amount of equity increases, which is consistent with financial theory. Mr. Rothstein has not recognized this in his calculations. Further, he uses the 5.38 percent as a return on equity and not a return on rate base, as it should be used. The following computes the return on equity with the requested return and a 50 percent equity and 50 percent debt capital structure.

	Percent	Annual Cost Rate	Weighted Cost
Utility Equity	50%	7.49%	3.75
Debt	50%	3.27%	1.64
Total Utility Capital			5.38%

It would change his computations if he used this cost of equity.

Also, I would not characterize the return that the utility earns as cash to the City of Milwaukee as Mr. Rothstein does on page 17 line 18. To the extent that a utility has surplus funds, a municipality may take funds from a utility. However, I do not think MWW has any surplus funds for now or in the foreseeable future. MWW has been reinvesting all of its earnings back into the utility. I may have further comments on Mr. Rothstein's new approach to municipal rate of return.

Q. Please describe the clarifications you have.

A. One item that may be confusing is Ms. Lewis' statement on Line 18 of page 16 of her direct testimony that "MWW's water main replacement budget for the test year is $10 million…." In MWW's rate application filed March 4, 2014, MWW included $3 million for water main construction in 2014, of which $2.25 million is for utility financed plant and $0.75 million is for developer contributed plant. I adjusted the 2014 main additions

forecast to be $6.4 million of main that will be closed to plant in service in 2014. This was primarily for construction that had previously been started but held for accounting purposes in construction work in progress (CWIP). Per page 21 of my initial testimony, MWW typically has a two-and-a-half-year period between the completion of construction and the accounting entry to transfer construction from CWIP to plant in service.

I obtained knowledge of MWW processes in the response to AWW 3 question 7, (PSC REF#: 201788). The test year $10 million budget for main replacements would refer to the first year of a six-year plan that MWW submitted to the Mayor and the Common Council. She describes the submission of the 2015 six-year plan on page 17, lines 5 to 7 of her testimony. A further step in MWW's process is the submission of a final list of projects "to the Milwaukee Common Council each year for preliminary engineering and subsequent construction" as described in Ms. Lewis direct testimony page 16, lines 9 to 11. As can be seen from the time line for construction on page 21 of my direct testimony, it is typically three-and-a-half years between the approval of preliminary engineering and the completion of construction. With these processes, it is unlikely that $10 million dollars of main replacements will be started and finished in 2014.

Q. Do you have any further clarifications to Ms. Lewis' testimony?

A. Yes, I am concerned that Ms. Lewis states on page 17, lines 1 to 4:

> The PSC's standard process of setting rates using a utility basis and revenue requirements for a single test year does not account for the financing methods of capital improvement projects in general or take into account future capital improvements and financing methods.

I simply do not believe that is an accurate statement. Perhaps there will be an opportunity for the Commission to better explain the financing options available to

MWW. In any case, the Commission has many years of experience in multiple industries of setting rates that provide utilities with financial integrity that allows access to capital in order to provide reliable, good quality utility service.

Q. Do you have any further clarification?

A. Yes, I do want to clarify the statements about the interaction between staff and MWW as alluded to on page 7, lines 18 to 20, of Ms. Lewis's testimony concerning infrastructure investment and rate of return. Staff has encouraged MWW to evaluate the current condition of its water system. Staff has encouraged MWW to ask for the amount of funds that it needs in order to properly keep up its water system. Staff has expressed concern to MWW that it has not provided a good analysis of its upcoming needs for capital, as I will discuss in greater detail later in this testimony. A well-managed company would have a good handle on what its upcoming capital needs will be. It is appropriate for the Commission to encourage efficient management. In private industry, investors evaluate the efficiency of management and reward efficient management and are more bearish to inefficient management. However, with a municipally-owned utility, there are no outside investors. So, there is a different dynamic when the owners are the management. In authorizing ROR, the Commission can consider whether its actions will minimize costs to ratepayers. With a municipal utility, the Commission can lower the ROR because the Commission stands in lieu of competition and wants to provide the same incentives for efficiency as the market would provide. Alternatively, the Commission may grant a partial amount of the requested ROR and withhold approving a greater amount or the full amount of ROR until a utility meets the conditions imposed by the Commission.

Q. What are your views about possible adjustments to ROR?

A. I am not an attorney, but I am aware that the Commission has many forms of authority. For example, to the extent the Commission finds service is inadequate, it can issue any just and reasonable order to assure certain actions are taken in the future. (Wis. Stats. § 196.02) So, I think the Commission could potentially provide a certain ROR contingent upon specific actions by MWW.

Overall, the Commission will evaluate all the information on the record in its determination of just and reasonable rates.

Q. Do you have additional information about how a water utility can evaluate its long-term capital needs?

A. Yes. In 2005, the Madison Water Utility prepared an Infrastructure Management Plan Report. That report contained the following summary on page 5.7 of that report:

> In September 2005, after reviewing reinvestment needs, annual funding capacity, rate increase potential, and Utility bonding capacity, the Utility provided information about projected capital spending for reinvestment for the next 15 years. The Utility has proposed moderate annual budget increases for facilities to build up from $250,000 per year in 2007 to $2 million per year by 2025. The annual amount budgeted for pipeline replacement is $1.3 million per year in 2005, increasing annually until it reaches $9 million per year in 2024. Reinvestment into distribution infrastructure should be reviewed annually as additional data is collected, and additional definitions are formalized for level of service for the distribution system.

Like Madison Water Utility, MWW should use the data it maintains for main breaks to evaluate its capital needs over at least the next 10-year period. MWW should use the 70 pages of the Water Main Breaks Experience Index (WMEI) and the 270-page list of every break to determine how much main will need to be replaced in the next 10 years. Samples of these reports are included in my Ex.-PSC-Waymouth-4. They show that

MWW intends to start replacement projects in 2014 for about one page of the 70 pages of the WMEI. Without more comprehensive information, limited data is available to the Commission for oversight of the sustainability of MWW's main replacements. Provision of more information about its upcoming needs for capital could further support MWW's requested ROR.

Q. Without such an Infrastructure Plan, what information does the Commission have to evaluate the sufficiency of MWW's main replacements?

A. The benchmark depreciation rates suggest 20 to 25 miles of main should be replaced per year. In initial testimony, I identified that it would take 29 years to replace all World War II vintage main at MWW's proposed replacement rate. I provide a simple overview calculation here that one seventieth of the pages on a list will be started in 2014. Based on these type of indicators, it does not appear that 15 miles per year will be sufficient. More information would aid the Commission in this evaluation.

Q. What is the purpose of estimating main replacements 10 years from now?

It is needed to evaluate the MWW proposed annual main replacement budget. One cannot evaluate the adequacy of an annual budget without an estimate of the overall funding needs over at least the next 10 years. Nowhere has Ms. Lewis provided any estimate of the dollar amount of main that needs to be replaced in the near term.

I suggest that MWW consider hiring an independent consultant to use information like MWW's main break records and provide an estimate of MWW's upcoming capital needs for main replacements.

Q. Why would use of an independent consultant be beneficial?

A. As Ms. Lewis has described in her testimony, MWW obtains approval from the Mayor and the Milwaukee Common Council for its construction budgets. As I mentioned briefly in my initial testimony, water mains are less visible infrastructure than other public works projects. Those decision makers need information so they can be responsive to MWW's needs. It may be information that those decision makers would rather not hear. Accordingly, it may be best if the information comes from someone other than the water utility management. In my initial testimony, I suggested that MWW should have a means of receiving special consideration of its capital needs. Decision makers cannot make good decisions without adequate information. By "special consideration" I mean a full understanding of the current condition of the water system and its likely need for capital over at least the upcoming 10 years.

Q. Do you have any further comments?

A. Yes, I do want to comment on Ms. Lewis' proposal of steady annual investments on page 17, lines 7 to 11. Conceptually, steady annual investment is an approach that I believe could work for a utility the size of MWW. However, the fundamental problem is that MWW has not been making steady annual investments. When you look at MWW's Water Main Replacement Report which was filed with its application, you can see that only in a few years around 2007 did MWW replace even close to one percent of its mains. That report shows that MWW has not been replacing one percent of the current system since at least 1972. In considering intergenerational equity, large one-time projects generally are not cash financed, but would be paid for closer to the period of time that is benefited. In order to evaluate such issues, the Commission needs a realistic

estimate of MWW's upcoming capital needs based on the current condition of its infrastructure.

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.

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